

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2011-271-E

In re:)	
Application of Duke Energy Carolinas, LLC)	ORDER APPROVING
For Authority to Adjust and Increase Its Electric)	SETTLEMENT AGREEMENT
Rates and Charges)	AND INCREASE IN RATES AND
)	CHARGES
)	

I. INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (the “Commission”) on the Application of Duke Energy Carolinas, LLC (“Duke Energy Carolinas” or the “Company”) filed August 5, 2011, (the “Application”) requesting authority to adjust and increase its electric rates, charges, and tariffs. The Application was filed pursuant to S.C. Code Ann. §§ 58-27-820, 58-27-870 (Supp. 2010) and 26 S.C. Code Ann. Regs. 103-303 and 103-823 (Supp. 2010).

On August 5, 2011 and also with its Application, the Company filed the direct testimony of Jeffrey Bailey, Director, Pricing and Analysis for Duke Energy Carolinas; Stephen G. De May, Senior Vice President, Investor Relations and Treasurer of Duke Energy Corporation (“Duke Energy”); Catherine Heigel, President of Duke Energy Carolinas for South Carolina; Robert B. Hevert, President of Concentric Energy Advisors, Inc.; Dhiaa Jamil, Group Executive and Chief Generation Officer of Duke Energy and Chief Nuclear Officer of Duke Energy Carolinas; Jane McManeus, Director, Rates for Duke Energy Carolinas; Carol E. Shrum, Vice President, Rates for Duke Energy Carolinas; Jim L. Stanley, Senior Vice President, Power Delivery for Duke Energy’s Franchised Electric and Gas Business; Phillip O. Stillman, General

Manager of Regulatory Accounting and Planning for Duke Energy Business Services, LLC; and J. Danny Wiles, Vice President of Franchised Electric and Gas Accounting for Duke Energy. Exhibits were included with the direct testimony of witnesses Bailey, Heigel, Hevert, McManeus, Shrum, Stillman, and Wiles. The Company filed supplemental direct testimony and an exhibit for Company witness Bailey on November 11, 2011.

The Company's general electric rates and charges were last approved by the Commission in Docket No. 2009-226-E, Order No. 2010-79, dated January 27, 2010.

In this Application, the Company requested a revenue increase of approximately \$216 million and a return on equity ("ROE") of 11.50%.

On August 17, 2011, the Commission's Docketing Department instructed the Company to publish a Notice of Filing and Hearing in newspapers of general circulation in the areas affected by the Company's Application by August 29, 2011. The Notice of Filing and Hearing indicated the nature of the Company's Application and advised those desiring to participate in the proceeding, scheduled to begin December 7, 2011, of the manner and time in which to file appropriate pleadings. The Company also had to notify each affected customer of the hearing by September 28, 2011, and provide a certification to the Commission by October 19, 2011. On September 16, 2011 and October 18, 2011 the Company filed affidavits with the Commission demonstrating that the Notice was duly published in accordance with the Docketing Department's instructions.

Pursuant to Commission Order No. 2011-665¹, the Docketing Department scheduled public hearings in the Counties of Anderson, Greenville, Lancaster, and Spartanburg. On September 19, 2011, the Commission's Docketing Department instructed the Company to notify

¹ The purpose of the night hearings was to provide a forum, at a convenient time and location, for customers of Duke Energy Carolinas to present their comments regarding the service and rates.

each affected customer of the Public Night Hearings by September 30, 2011. On October 18, 2011, the Company filed affidavits demonstrating that these Notices of Public Hearings were duly published in accordance with the Docketing Department's instructions. Additionally, on October 28, 2011, the Docketing Department issued a revised testimony schedule.

The South Carolina Energy Users Committee ("SCEUC") represented by Scott Elliott, Esquire, filed a petition to intervene on August 23, 2011. Wal-Mart Stores East, LP and Sam's East, Incorporated (collectively referred to as "Walmart") represented by Holly Rachel Smith, Esquire and Thomas L. Moses, Esquire filed a petition to intervene on October 3, 2011. The Commission of Public Works of the City of Spartanburg South Carolina and Spartanburg Sanitary Sewer District (collectively referred to as "Spartanburg") represented by Richard L. Whitt, Esquire and Timothy F. Rogers, Esquire filed a petition to intervene on October 18, 2011. The Office of Regulatory Staff ("ORS"), automatically a party pursuant to S.C. Code Ann. § 58-4-10(B) (Supp. 2010), was represented by Shannon Bowyer Hudson, Esquire and Courtney Dare Edwards, Esquire. Duke Energy Carolinas was represented by Timika Shafeek-Horton, Esquire, Charles A. Castle, Esquire, Frank R. Ellerbe, III, Esquire, Bonnie D. Shealy, Esquire, and Heather S. Smith, Esquire. Collectively, Duke Energy Carolinas, SCEUC, Spartanburg, Walmart, and ORS are referred to as "the Parties" or individually as a "Party."

On November 14, 2011, ORS filed the direct testimony of Sharon G. Scott, Senior Audit Manager; Christina Stutz, Auditor; Henry N. Webster, II, CPA, Auditor; Douglas H. Carlisle, Jr., Ph.D., Economist; Leigh C. Ford, Senior Electric Utilities Specialist in the Electric Department; and M. Anthony James, P.E., Manager in the Electric Department. Exhibits were included with the direct testimony of witnesses Scott, Carlisle, and James. On November 15, 2011, ORS filed revised direct testimony and exhibits of witnesses Carlisle and Scott. SCEUC filed the direct

testimony and exhibits of Kevin W. O'Donnell, President of Nova Energy Consultants, Inc. on November 14, 2011. Walmart filed direct testimony and exhibits of Steve W. Chriss, Senior Manager, Energy Regulatory Analysis, for Wal-Mart Stores, Inc. on November 14, 2011. On November 21, 2011, the Company filed the rebuttal testimony of witnesses Bailey, De May, Heigel, Hevert, Shrum, Stillman, and Barbara G. Yarbrough, Rates Director for Duke Energy Carolinas. Exhibits were included with the rebuttal testimony of witnesses Bailey, Heigel, Hevert and Yarbrough. Surrebuttal testimony was filed by SCEUC witness Kevin O'Donnell on December 2, 2011.

On November 30, 2011, ORS, Spartanburg and Duke Energy Carolinas, filed a Settlement Agreement and Attachments A, B, and C. On December 7, 2011, ORS, Walmart and Duke Energy Carolinas ("Settling Parties") filed a Replacement Settlement Agreement to take the place of the November 30, 2011 Settlement Agreement. Filed with the Replacement Settlement Agreement ("Settlement Agreement") were Supplemental Attachments A and B. Settlement Agreement Supplemental Attachment A reflects the Company's operating experience, accounting adjustments and the increase in annual revenues from base rates of \$92,844,000. Settlement Agreement Supplemental Attachment B shows, by customer class, the allocation of the increase in revenues and the respective rates of return by customer class. Duke Energy Carolinas filed settlement testimony of witnesses Heigel, Hevert, and Shrum on November 30, 2011.

Public hearings were held on October 19, 2011 in Spartanburg; November 8, 2011 in Lancaster; November 9, 2011 in Greenville; and November 10, 2011 in Anderson. Witness Yarbrough's rebuttal testimony was filed in response to certain testimony provided by members of the public during the night hearings. A petition and prepared remarks from the Greenville

Night Hearing were accepted into the record as Hearing Exhibits 1 and 2, respectively.

The Commission conducted an evidentiary hearing on this matter from December 7, 2011 through December 8, 2011 in the hearing room of the Commission with the Honorable John E. Howard presiding. At the outset of the hearing, ORS counsel described the Settlement Agreement. The Settlement Agreement, including its Supplemental Attachments A and B, was accepted into the record as composite Hearing Exhibit 3. The Settlement Agreement is attached as Order Exhibit No. 1 and incorporated herein by reference. On December 7, 2011, Richard L. Whitt filed a letter on behalf of Spartanburg, which was entered into the record as Hearing Exhibit 12. The letter stated that Spartanburg does not oppose the Settlement Agreement or the Commission's approval of the Settlement Agreement.

Public witnesses Seth Powell and Dr. Richard Baldwin appeared and testified. Duke Energy Carolinas witnesses Heigel, Jamil, De May, Wiles, Hevert, Shrum, McManeus, Stillman, Bailey, Stanley, and Yarbrough; SCEUC witness O'Donnell; Walmart witness Chriss; and ORS witnesses Stutz, Scott, Webster, Carlisle, Ford, and James appeared, gave summaries of their testimonies, and answered questions from counsel and the Commission.

Duke Energy Carolinas witness Heigel provided an overview of the reasons for the Company's request for an increase in electric rates and charges and the ongoing system modernization efforts. Witness Jamil described the Company's fleet modernization program and other capital additions since the Company's last general rate case in 2009 and operational performance of Duke Energy Carolinas' nuclear, fossil, hydroelectric, and renewable generation portfolio during the test period ending December 31, 2010. Company witnesses De May and Wiles testified as a panel. Witness De May addressed the Company's financial objectives, capital structure and cost of capital, while witness Wiles addressed the financial position and results of

Duke Energy Carolinas' operations for the test period ending December 31, 2010 and the Company's depreciation expense and nuclear decommissioning costs recorded during the test period. Company witness Hevert presented his independent analysis of a fair ROE which would allow Duke Energy Carolinas to attract capital on reasonable terms and maintain financial strength. Duke Energy Carolinas witnesses Shrum and McManeus testified as a panel on accounting issues and fuel costs.

The Commission reconvened on December 8, 2011 with witnesses Stillman and Bailey testifying as a panel. Witnesses Stillman and Bailey addressed the proposed rate design and customer class allocations. Witnesses Stanley and Yarbrough testified as a panel on the Company's transmission and distribution infrastructure, customer service issues, and testimony from the public witnesses at the night hearings.

SCEUC witness O'Donnell testified in support of ORS' adjustments and addressed his recommended 9.50% ROE and capital structure, among other items. Walmart witness Chriss testified in support of the Settlement Agreement.

ORS presented its first panel of witnesses which consisted of witnesses Stutz, Webster, and Scott. They each provided a summary of their testimony and explained the findings and recommendations as reflected in the ORS Audit Exhibits resulting from ORS' examination of Duke Energy Carolinas' Application and supporting books and records. ORS witness Carlisle testified regarding his study and analysis of markets, economic conditions, the Company's capital structure, and recommended a ROE for the Company. Witnesses Ford and James testified as a panel with each providing a summary and review of the ORS Electric Department's examination of the Company's Application.

As requested by the Commission, Duke Energy Carolinas filed three (3) late-filed hearing exhibits on December 22, 2011 on: (1) a comparison of the proposed residential rate increase to the amount of residential rate increase based on the proposed average percent increase of all customer classes; (2) Jim Rogers' and other executives' compensation for the test year allocated to South Carolina; and (3) information related to a night hearing speaker who resides in an apartment complex. The Commission asked for the number of tenants in the complex and their currently applicable rate schedules. The Parties filed proposed orders and legal briefs on January 18, 2012.

II. FINDINGS OF FACT

Based upon the Application, the Settlement Agreement, the testimony, and exhibits received into evidence at the hearing and the entire record of these proceedings, the Commission makes the following findings of fact:

A. JURISDICTION

1. Duke Energy Carolinas is a limited liability company duly organized and existing under the laws of the State of North Carolina. It is a public utility under the laws of the State of South Carolina and is subject to the jurisdiction of this Commission pursuant to S.C. Code Ann. § 58-3-140(A) (Supp. 2010). The Company is engaged in the business of generating, transmitting, distributing, and selling electric power to the public in western South Carolina and a broad area of central and western North Carolina. Duke Energy Carolinas is a wholly-owned subsidiary of Duke Energy, both having their offices and principal places of business in Charlotte, North Carolina.

2. The Commission has jurisdiction over the rates and charges, rate schedules, classifications, and practices of public utilities operating in South Carolina, including Duke Energy Carolinas, as generally provided in S.C. Code Ann. §§ 58-27-10, *et seq.* (1976 & Supp. 2010).

3. Duke Energy Carolinas is lawfully before the Commission based upon its Application for a general increase in its retail rates pursuant to S.C. Code Ann. §§ 58-27-820, 58-27-870, and 26 S.C. Code Ann. Regs. 103-303 and 103-823.

4. The appropriate test period for use in this proceeding is the twelve (12) months ended December 31, 2010.

B. SETTLEMENT AGREEMENT

5. Duke Energy Carolinas, by its Application and initial direct testimony and exhibits, originally sought an increase of approximately \$216 million in its annual electric sales revenues from South Carolina retail electric operations, and an ROE of 11.50%.

6. Duke Energy Carolinas submitted evidence in this case with respect to revenue, expenses and rate base using a test period consisting of the twelve (12) months ended December 31, 2010. The Settlement Agreement is based upon the same test period.

7. On December 7, 2011, ORS filed the Settlement Agreement,² on behalf of the Settling Parties, which resolved the issues in this proceeding with respect to Walmart, Duke Energy Carolinas, and ORS.

8. The Settlement Agreement provides for a revenue increase of \$92,844,000, after accounting and pro forma adjustments, and adopts ORS' recommended ROE of 10.50%.

² It should be noted that while not a signatory party to the Settlement Agreement, Spartanburg filed a letter on December 7, 2011 (Hearing Exhibit 12) indicating they did not object to the Settlement Agreement or the Commission's approval of the Settlement Agreement.

9. The Settling Parties agreed that Duke Energy Carolinas shall make a one-time shareholder contribution to AdvanceSC in the amount of \$4 million to be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs.

10. The Settlement Agreement sets forth the proposed revenue increases and the respective rates of return by customer class in Supplemental Attachment B.

11. The Commission, having carefully reviewed the Settlement Agreement and all of the evidence of record, finds and concludes that the provisions of the Settlement Agreement are just and reasonable as to all the Parties, are in the public interest, and should be approved in their entirety. The specific terms of the Settlement Agreement are addressed in the following findings of fact and conclusions.

III. EVIDENCE AND CONCLUSIONS

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 1 THROUGH 4

Duke Energy Carolinas is an electric utility subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. Sections 58-3-140(A) (Supp. 2010). South Carolina uses a historic twelve-month test period. 26 S.C. Code Ann. Regs. 103-823(A)(3). These findings and conclusions are informational, procedural and jurisdictional in nature and are not contested by any of the Parties.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NOS. 5 THROUGH 8

The Commission last approved the Company's general electric rates and tariffs in Order No. 2010-79 in Docket No. 2009-226-E. Order No. 2010-79 allowed an 11.0% ROE for the

Company, with new rates set on an ROE of 10.70% for its South Carolina retail jurisdictional rate base. The test period in that case was the twelve (12) months ended December 31, 2008.

On August 5, 2011, Duke Energy Carolinas filed its Application and initial direct testimony and exhibits, seeking an increase of approximately \$216 million or 14.6% average increase in its annual electric sales revenues from its South Carolina retail electric operations. The Company requested an 11.50% ROE.

Duke Energy Carolinas submitted evidence in this case with respect to revenue, expenses and rate base using a test period consisting of the twelve (12) months ended December 31, 2010. The Settlement Agreement is based upon the same test period.

The Settlement Agreement filed by the Parties on December 7, 2011 in this Docket provides for an increase of \$92,844,000 or a 5.98% average increase in Duke Energy Carolinas' annual revenues from kWh (kilowatt hour) sales from its South Carolina retail electric operations. Of this amount, \$90,654,000 is based on the accounting and pro forma adjustments shown on Exhibits SGS-1 and SGS-2 to the revised direct testimony of ORS witness Scott. The remaining \$2,190,000 is based on evidence submitted on December 6, 2011 showing that the new combined cycle plant at Buck Steam Station site ("Buck") and the new powerhouse downstream of the Bridgewater Hydro Station ("Bridgewater") were placed into service on November 27, 2011 and November 14, 2011, respectively. The revenue amount related to Buck is \$1,807,000 and the revenue amount related to Bridgewater is \$383,000. The ORS accounting and pro forma adjustments showing the \$92,844,000 are included in Supplemental Attachment A to the Settlement Agreement.

a) Need for Rate Increase

Company witness Heigel testified that the rate case is driven by the \$6.5 billion of capital invested in projects, including the modernization program that consists of retiring, replacing and/or upgrading generation plants and transmission and distribution systems. These projects are needed to provide safe, reliable and environmentally compliant electricity at reasonable costs. Duke Energy Carolinas' average age of generation and power delivery systems consists of: coal-fired power plants (61 years); nuclear generation system (30 years); hydroelectric (79 years); transmission and distribution systems (certain major components range in age between approximately 30 and 40 years).

On a South Carolina jurisdictional basis, Duke Energy Carolinas' gross rate base additions include new plant additions of approximately \$134 million for the Cliffside Unit 5 scrubber, \$166 million for the Buck Combined Cycle Plant, \$32 million for the Tornado/High Energy Line Break ("HELB") work at Oconee Nuclear Station ("Oconee"), \$43 million for the Bridgewater Powerhouse Replacement, \$223 million for General Maintenance and Nuclear fuel, \$214 million for costs associated with transmission and distribution, and \$54 million for other general plant additions. In addition to new plant, rate base additions attributable to Construction Work in Progress ("CWIP") are as follows: \$138 million for Cliffside Unit 6; \$127 million for Phase II of Oconee HELB; \$98 million for Dan River Combined Cycle; \$90 million associated with Other Nuclear, Fossil, Hydro, and Combustion Turbine projects; and \$57 million associated with Transmission, Distribution, and other General Projects. Including cost of capital, depreciation and property taxes, gross plant additions to the generation and power delivery systems translate into approximately \$191 million in additional annual revenue requirements according to the Company's testimony.

The need to modernize the system is also driven by environmental compliance requirements such as the need for emission controls to comply with a series of new proposed United States Environmental Protection Agency (“EPA”) rules regulating multiple areas relating to generation resources, such as mercury, SO₂, NO_x, coal combustion by-products and fish impingement/entrainment. These new EPA rules, if implemented, will increase the need for the installation of additional environmental control technology or retirement of coal fired generation in the 2014 to 2018 timeframe.

Witness Jamil testified that the Company has invested over \$2.6 billion in capital additions since the 2009 Rate Case for the nuclear, fossil/hydro and renewable fleets. These capital additions are part of the Company’s efforts to add new generation assets, maintain reliability, modernize existing assets for greater efficiency, continue with life extension efforts of nuclear units, relicensing ventures, as well as to comply with new or updated regulatory requirements. The major capital investments undertaken by the Company at Catawba Nuclear Station include continued replacement and upgrading of the service water system, and installing digital process systems (“DCS”) in the control room. DCS provides the operators state-of-the-art technology to operate the plant, control plant parameters by redundant instrumentation, and minimize transients or deviations of operating parameters. At the McGuire Nuclear Station, the DCS system is also being installed as well as an upgraded fire detection system. At Oconee, preparations for the installation of a new safety-related digital reactor protection system advanced the readiness for a 2011 implementation, as well as multiple equipment and systems upgrades to the facility. With respect to regulatory compliance, the Company continued modifications to the Oconee auxiliary building and emergency injection tanks to provide supplemental protection from the effects of seismic activity or other natural phenomenon based

on updated standards published in recent years. Also at Oconee, implementation of the new safety-related protected service water system progressed significantly, and the Company completed the work necessary to comply with regulatory requirements such as an NRC Security Rule, which required updated security measures at nuclear plants across the country.

Witness De May stated that the credit rating agencies and investors view the Company's ability to obtain timely cash recovery on prudently incurred costs as a major factor in assessment of the Company's financial strength and credit quality. Strong credit ratings and credit quality enable the Company to access the capital it needs to replace aging and retired infrastructure, to comply with environmental requirements, and to invest in new, more efficient technologies on reasonable terms for the benefit of its customers. Company witness Hevert explained the ability to earn a fair and reasonable ROE will help ensure access to capital markets, especially in uncertain financial markets.

b) Return on Equity

The Settlement Agreement provides for base rates to generate a revenue increase of \$92,844,000 from South Carolina retail electric operations at an ROE of 10.50%.

(1) Capital Structure

Duke Energy Carolinas witness De May testified that the Settlement Agreement supports the Company's financial objectives by allowing timely recovery of its investments in plant and equipment, providing sufficient cash flows to maintain its necessary capital expenditure program and service debt, and providing a fair and reasonable return to equity investors. The Company will have the opportunity to earn an overall rate of return of 8.10% on its South Carolina retail jurisdictional rate base of \$3,963,064,000 with a long-term debt cost of 5.39% and an allowed return of 10.50% on the equity component of a target capital structure comprised of 47% long-

term debt and 53% equity.

Company witness De May testified to specific objectives that support financial strength and flexibility that include: a) maintaining at least a 53% equity ratio for Duke Energy Carolinas on a financial capitalization basis; b) maintaining current credit ratings; c) ensuring timely recovery of prudently incurred costs; d) maintaining sufficient cash flows to meet obligations; and e) maintaining a sufficient return on equity to fairly compensate shareholders for their invested capital. The ability to attract capital (both debt and equity) on reasonable terms is vitally important to the Company and its customers, and helps the Company meet its overall financial objectives.

According to the “Quarterly Financial Report for the twelve months ending March 31, 2011,” filed with the Commission in Docket No. 2006-268-E, Duke Energy Carolinas’ capital structure was 43.4% long-term debt and 56.6% equity. In its Application, Duke Energy Carolinas applied a target capital structure of 47% debt and 53% equity.

Capital structure is an important component of credit quality. Witness De May explained that equity investors provide the foundation of a company’s capitalization by providing significant amounts of capital, for which an appropriate economic return is required. Returns to equity investors are realized only after all operating expenses and fixed payment obligations of the business have been paid. Since equity investors are the last to receive any earnings and cash flows, their capital is most at risk if the Company suffers a downturn in business or general financial conditions. The priority of bondholders over equity investors assures the former a measure of protection. The Company testified that the greater the equity component of capitalization, the safer the returns are to debt investors, which translates into higher credit quality.

Witness De May testified that Duke Energy Carolinas' equity component enables it to maintain its current credit ratings, financial strength and flexibility. Duke Energy Carolinas' outstanding debt is rated by Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"). Obligations carrying a credit rating in the "A" category are considered strong investment-grade securities subject to low credit risk for the investor. S&P's current ratings for Duke Energy Carolinas' secured debt is "A" and its unsecured debt is "A-." Moody's current ratings for Duke Energy Carolinas' secured debt is "A1" and its unsecured debt is "A3." As of the date of filing, Duke Energy Carolinas has a "Stable" outlook by both S&P and Moody's. The ratings outlook assesses the potential direction of a long-term credit rating over an intermediate term (typically six (6) months to two (2) years). Duke Energy Carolinas' "Stable" outlook means that the credit ratings are not likely to change at this time; however, a change in outlook or rating could occur if the Company experiences a change in its business or financial risk.

The target capital structure of 47% debt and 53% equity is appropriate for the Company in this proceeding. The debt/equity ratio is consistent with the average the Company has maintained for the last decade. The Commission recognizes that, as discussed by witness De May, a strong equity component is a factor in determining the Company's credit rating. Based on the testimony provided by witnesses Heigel, Jamil, and Stanley, the Commission recognizes the Company's need to raise capital. Accordingly, the Commission finds and concludes that the target capital structure of 47% debt and 53% equity is just and reasonable in light of all the evidence presented.

(2) Return on Equity

In setting rates, the Commission must determine a fair rate of return that the utility should be allowed the opportunity to earn after recovery of the expenses of utility operations. The legal

standards applicable to this determination are set forth in Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 602-603 (1944) and Bluefield Water Works and Improvement Co. v. Pub. Serv. Comm'n of W. Va., 262 U.S. 679, 692-93 (1923). These standards were adopted by the South Carolina Supreme Court in Southern Bell Tel. & Tel. Co. v. S.C. Pub. Serv. Comm'n, 270 S.C. 590, 595-96, 244 S.E.2d 278, 281 (1978). The Court stated:

What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties....

Southern Bell Tel., 270 S.C. at 595-96, 244 S.E.2d at 281 (quoting Bluefield, 262 U.S. at 692-93). These cases also establish that the process of determining rates of return requires the exercise of informed judgment by the Commission. The South Carolina Supreme Court has held that:

[T]he Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its ratemaking function, moreover, involves the making of 'pragmatic adjustments' Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. . . . The ratemaking process under the Act, *i.e.*, the fixing of 'just and reasonable' rates, involves the balancing of the investor and the consumer interests. Thus we stated in the Natural Gas Pipeline Co. case that 'regulation does not insure that the business shall produce net revenues.' . . . [B]ut such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on debt and dividends on the stock. . . . By that standard the return to the equity owner should

be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Southern Bell Tel., 270 S.C. at 596-97, 244 S.E. 2d at 281 (quoting Hope Natural Gas Co., 320 U.S. at 602-03. These principles have been employed by the Commission and the South Carolina Courts consistently.

Company witness Hevert testified in support of the Settlement Agreement's proposed ROE of 10.50%. Witness Hevert initially recommended an ROE of 11.50% as stated in the Company's Application; however, he indicated that although the 10.50% ROE included in the Settlement Agreement was below the low end of his recommended range and below his specific recommendation, it was within the range of the mean analytical results presented in his Rebuttal Testimony, in particular the Discounted Cash Flow-based models. In the context of the Settlement Agreement, taken in its entirety, witness Hevert testified that the 10.50% ROE would be appropriate to support the Company's ability to access the capital markets at reasonable rates. He testified that Duke Energy Carolinas needs to maintain its financial strength and credit quality to be in a position to finance its capital needs on reasonable terms. The methods for estimating the cost of equity for Duke Energy Carolinas employed by witness Hevert included the Discounted Cash Flow ("DCF") model and the Capital Asset Pricing Model ("CAP-M"). In addition to the methodologies, his recommendation also took into consideration: (1) the level of coal-fired generation owned and operated by the Company; (2) the risk of retirement and costly capital improvements due to more stringent environmental regulations; (3) the level of nuclear generation owned by the Company and the impacts that the recent events in Japan may have on the Company's nuclear units going forward; (4) the incremental risks

associated with the Company's need to fund substantial capital expenditures; and (5) flotation costs associated with equity issuances.

ORS witness Carlisle provided testimony regarding the Company's cost of equity. He used the DCF model and the Comparable Earnings Model ("CEM") approach to estimate the Company's cost of equity capital. Witness Carlisle recommended that rates be set on an ROE of 10.50%. His analysis resulted in the following ROE range: DCF ROE of 10.26% and a CEM ROE of 10.74%. The mid-point of this range is 10.50%.

SCEUC witness O'Donnell primarily testified that he performed a DCF analysis resulting in an investor return requirement range of 8.75% to 9.75%. and that the CEM method produced a return on equity in the range of 8.50% to 9.50%. Witness O'Donnell recommended that the Commission grant Duke Energy Carolinas a return on equity of 9.50% since the ROE is in the middle-to-high end of the range of his DCF results, and in the high-end range for his CEM analysis.

In considering the appropriate ROE for Duke Energy Carolinas, the Commission reviewed the methodologies and conclusions of the witnesses who employed numerical models to calculate the ROE for the Company, considered the evidence related to market conditions and investor expectations, and reviewed the evidence in support of the ROE proposed in the Settlement Agreement. The Commission agrees with ORS' position that the determination of an appropriate ROE should balance the future outlook for returns against historical trends, without an inappropriate emphasis on transitory factors; therefore, historical growth figures which incorporate the recent recession should not receive undue weight going forward. Moreover, the Commission does not believe that a utility's investments in plant additions should be viewed as a long-term drag on earnings since regulated electric utilities may recover these investment and

earn a return on them. Under today's unusual economic circumstances, the usefulness of the CAP-M at this time as an appropriate methodology is suspect, especially in light of the Federal Reserve's shift into long-term Treasury bond purchases in September 2011.

The Settlement Agreement ROE of 10.50% supports the Company's credit profile and maintains the Company's ability to access the capital markets at reasonable rates. The 10.50% ROE is also supported by the analytical results presented in testimony by ORS witness Carlisle and Duke Energy Carolinas witness Hevert. The Commission concludes that the Settling Parties' recommended ROE of 10.50% is just and reasonable and in the public interest.

(3) Rate Base and Revenue Increase

The South Carolina Supreme Court has defined *rate base* as "the amount of investment on which a regulated public utility is entitled to an opportunity to earn a fair and reasonable return; and represents the total investment in, or the fair value of, the used and useful property which it necessarily devotes to rendering the regulated services." Hamm v. Pub. Serv. Comm'n, 309 S.C. 282, 286, 422 S.E.2d 110, 112 (1992) (citing Southern Bell Tel., 270 S.C. at 600, 244 S.E.2d at 283). "Rate base should reflect the actual investment by investors in the Company's property and value upon which stockholders will receive a return on their investment." Parker v. S.C. Pub. Serv. Comm'n, 280 S.C. 310, 312, 313 S.E.2d 290, 292 (1984). The Commission has the statutory authority after hearing to "ascertain and fix the value of the whole or any part" of Duke Energy Carolinas' rate base, and may "ascertain the value of all new construction, extensions and additions" to such property. S.C. Code Ann. § 58-27-180 (Supp. 2010).

Duke Energy Carolinas, by its Application and initial direct testimony and exhibits, originally sought an increase of \$216 million or 14.6%, from its South Carolina retail electric

operations. The Settlement Agreement provides for an increase of \$92,844,000 in base rates or 5.98%, when compared to adjusted test year revenues.

ORS conducted an examination of the Company's Application and supporting books and records including rate base items. On the basis of this examination, hearing exhibits and testimony, the Commission can determine and find proper balances for the components of the Company's rate base, as well as the propriety of related accounting adjustments. The Commission determines the appropriate rate base, as adjusted, for the test period. This practice enhances the timeliness of the effect of such action and preserves the reliance on historic and verifiable accounts without resorting to speculative or projected figures. The Commission finds it reasonable to continue this regulatory practice and uses a rate base, as adjusted, for the test period ending December 31, 2010, in this proceeding.

With regard to the accounting adjustments, the South Carolina Supreme Court has concluded that adjustments to the test year should be made for any known and measureable out-of-period changes in expenses, revenues, and investments that would materially alter the rate base. "The object of the test year is to reflect typical conditions. Where an unusual situation exists which shows that the test year figures are atypical the [Commission] should adjust the test year data. Any other standard would negate the aspect of finality created by a test year time limitation." Parker, 280 S.C. at 312, 313 S.E.2d at 292.

ORS filed direct testimony applying several adjustments to conclude that a South Carolina retail electric rate base of \$3,963,064,000 was appropriate. Settlement Agreement Supplemental Attachment A shows Duke Energy Carolinas' operating experience, rate base and

rate of return for Total Company Per Books and South Carolina retail operations, excluding Greenwood County Electric Power Commission ("Greenwood") for the test year.³

ORS witness Scott testified that ORS verified total (North Carolina and South Carolina) electric operating revenues of \$6,374,883,000, total operating expenses of \$5,356,569,000 and net operating income for return of \$1,018,314,000. Total electric rate base was \$13,906,147,000. Witness Scott also explained the allocation to SC Retail Per Books of a net operating income for return of \$248,330,000 and total rate base of \$3,254,288,000, resulting in a rate of return of 7.63%, and a return on equity of 9.62%, as reflected in Hearing Exhibit 19. ORS witness Scott explained ORS' proposed Accounting and Pro Forma Adjustments which were subsequently incorporated into the Settlement Agreement Supplemental Attachment A, Hearing Exhibit 3.

Pursuant to the Settlement Agreement Supplemental Attachment A, the Settling Parties agreed upon operating revenues of \$1,677,577,000, operating expenses of \$1,356,979,000, customer growth of \$562,000, and original cost rate base of \$3,963,064,000 for South Carolina excluding Greenwood. As Duke Energy witness Hevert testified, the Settlement Agreement will provide the Company with the opportunity to earn an overall ROE of 10.50% on a target capital structure based upon 47% long-term debt and 53% equity.

SCEUC witness O'Donnell originally testified that a \$121,800,000 revenue increase was appropriate. After reviewing ORS' adjustments, he supported a net increase in allowable revenues of \$92,844,000. He further recommended that the Commission accept all of ORS' accounting adjustments. By accepting those adjustments and using his recommended ROE of

³ The revenue and cost of service related to the Greenwood County Electric Power Commission are excluded pursuant to S.C. General Assembly Act 1293 of 1966 and Duke Power Co. v. S.C. Pub. Serv. Comm'n, 284 S.C. 81, 326 S.E.2d 395 (1985).

9.50%, the average increase as proposed by witness O'Donnell would be 3.48% instead of the 5.98% agreed to in the Settlement Agreement.

Based on the Settlement Agreement's provisions, testimony and exhibits of all the Parties, the Commission finds and concludes that a \$92,844,000 increase in the level of base rates for Duke Energy Carolinas' South Carolina retail customers, is appropriate and that an overall rate of return of 8.10% on South Carolina retail jurisdictional rate base and an ROE of 10.50%, is just and reasonable in light of the substantial evidence in the record.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 9

The Settling Parties agree that Duke Energy Carolinas shall make a one-time shareholder contribution to AdvanceSC in the amount of \$4 million to be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs. After reviewing the goals of AdvanceSC, the Commission finds that the one-time donation would continue to balance the concerns of ratepayers as well as the Company and also further economic development. Therefore, we find that the one-time contribution, set forth in the Settlement Agreement, is in the public interest, just and reasonable, and supported by the evidence in the record.

EVIDENCE FOR FINDINGS AND CONCLUSIONS NO. 10

Under South Carolina law, the Commission is vested with the authority to fix just and reasonable utility rates. S.C. Code Ann. §§ 58-3-140, 58-27-810 (1976 & Supp. 2010). Under this statute, the Commission has traditionally adhered to the following principles:

- (a) the revenue-requirement or financial-need objective, which takes the form

of a fair-return standard with respect to private utility companies; (b) the fair-cost-apportionment objective, which invokes the principle that the burden of meeting total revenue requirements must be distributed fairly among the beneficiaries of the service; and (c) the optimum-use or customer-rationing objective, under which the rates are designed to discourage the wasteful use of public utility services while promoting all use that is economically justified in view of the relationships between cost incurred and benefits received.

Bonbright, Principles of Public Utility Rates 292 (1961). These criteria have been used by the Commission in previous cases and are again utilized here. (see, e.g., Order No. 2005-2 at 105 and 2003-38 at 76).

Once a utility's revenue requirement has been determined, a rate structure must be developed that yields that level of revenues. The basic objective of a rate structure is to enable a company to generate its revenue requirement without unduly burdening one class of customer to the benefit of another. Proper rate design results in revenues where each customer, and each customer class, pays, as close as practicable, the cost of providing service to them.

The Settlement Agreement provides for the agreed-upon increase in annual revenues of \$92,844,000. The retail increases by customer class proposed by ORS and contained within the Settlement Agreement are as follows: 7.05% for the residential class, 5.21% for the general service class, 5.13% for the industrial class, and 5.84% for the lighting class.

Company witness Heigel testified that the Settlement Agreement reflects a constructive approach to providing necessary rate relief that will allow the Company to maintain its financial strength, credit quality, and continue to provide high quality electric utility service to its customers, while at the same time mitigating the impact of the rate increase on customers. The Settlement Agreement allows for an overall average net rate increase to Duke Energy Carolinas' customers of 5.98% effective February 6, 2012.

Company witnesses Bailey and Stillman discussed the Company's processes for

developing its rate proposals. Duke Energy Carolinas witness Stillman prepared the cost of service studies that Bailey used as a major component for the rate design. The purpose of a cost of services study is to allocate the Company's revenues, expenses, and rate base among the regulatory jurisdictions and customer classes based on their service requirements.

The rate of return by class recommended by ORS and contained within the Settlement Agreement are as follows: 7.79% for the residential class, 8.31% for the general service class, 8.25% for the industrial class, and 9.80% for the lighting class. The overall rate of return for total South Carolina retail is 8.10%. ORS witness James testified that in developing the returns by class, ORS limited cross-subsidization of customer classes by employing a $\pm 10\%$ "band of reasonableness" relative to the overall retail rate of return. ORS was successful in bringing all the customer classes within this band except for the lighting class. Company witnesses Bailey and Stillman stated that once all costs and revenues are assigned, the study identifies the return on investment the Company earned during the test year. These returns can then be used as a guide in designing rates to provide the Company an opportunity to recover its costs and earn its allowed rate of return.

Company witness Bailey further testified that retail rates should produce rates of return among classes that bear a reasonable relationship to the Company's overall rate of return, and should provide movement toward equal rates of return among classes. The Commission is mindful of the implications of a rate increase on any class of customers, and also of the financial requirements of the utilities it regulates.

The Commission concludes that the proposed revenue increases and the respective rates of return by customer class as set forth in Settlement Agreement Supplemental Attachment B represent an appropriate movement toward comparable returns, and bear a reasonable

relationship to the Company's overall rate of return. As such, the proposed revenues and allocations are just, reasonable and supported by the evidence in the record.

The evidence in support of the findings of fact are found in the verified Application, the Settlement Agreement, pleadings, testimony and exhibits in this Docket, and the entire record in this proceeding.

IV. CONCLUSION AND ORDER

After hearing the testimony of the witnesses and based on the Commission's review of the Application, the Settlement Agreement, and the testimony and exhibits submitted during the hearing, the Commission adopts as just and reasonable and in the public interest all terms and provisions of the Settlement Agreement as a comprehensive resolution of all issues. These include: (1) the accounting and pro forma adjustments appended to the Settlement Agreement as Supplemental Attachment A; (2) base rates generating a revenue increase of \$92,844,000; (3) rates in this proceeding established on a 10.50% ROE; (4) Duke Energy Carolinas making a one-time contribution in the amount of \$4 million to be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs; and (5) adopting the proposed revenue increases by class and the respective rates of return in Settlement Agreement Supplemental Attachment B. Lastly, the Company's services are adequate and are being provided in accordance with the requirements set forth in the Commission's rules and regulations pertaining to the provision of electric service.

IT IS THEREFORE ORDERED THAT:

1. The Settlement Agreement entered into by the Settling Parties to this Docket is adopted and approved as just and reasonable in its entirety;
2. That Duke Energy Carolinas shall be allowed to increase its rates and charges effective for service rendered as of February 6, 2012 so as to produce an increase in annual revenues from base rates for its South Carolina retail operations of \$92,844,000 based upon the adjusted test year level of operations;
3. The calculation of the base rates required to generate a \$92,844,000 revenue increase shall be established based on a 10.50% ROE;
4. The accounting adjustments in the Settlement Agreement are adopted:
5. Duke Energy Carolinas' shall make a one-time contribution in the amount of \$4 million to be used to fund Share the Warmth and other public assistance programs, manufacturing competitiveness grants, economic development and/or education/workforce training programs;
6. That the rate design and revenue allocation proposed by the Company in its Application, and in its testimony and exhibits filed in this proceeding, as modified by the changes agreed upon in the Settlement Agreement, are approved;
7. The Parties shall abide by all terms of the Settlement Agreement; and
8. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

John E. Howard, Chairman

ATTEST:

David A. Wright, Vice Chairman
